

In Re Lange, #388-04260-S7
State of Oregon v. Lange, #88-0560-S
BAP Opinion 10/24/90

11 U.S.C. §506(a)
11 U.S.C. §506(d)
11 U.S.C. §722
11 U.S.C. §1111(b) (2)
11 U.S.C. §1322(b) (2)

The BAP reversed the Bankruptcy Court's oral decision and held that a chapter 7 debtor may not use §506(d) to avoid the undersecured portion of a creditor's lien against real property. The BAP adopted the reasoning of In re Denshup to reconcile §§722, 1111(b) and 1322(b) with §506. The panel decided that to permit a chapter 7 debtor to "strip down" liens would enhance the debtor's rights under a liquidation over the reorganization chapters and render §722, the redemption statute, meaningless.

P90-35 (12)

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DISTRICT OF OREGON
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OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re) BAP No. OR-89-1502-JMeV
DONALD G. LANGE,)
Debtor.) Adv. No. 88-0560(S)

STATE OF OREGON, by and
through the Director of the
DEPARTMENT OF VETERANS' AFFAIRS,
and ASSOCIATES FINANCIAL
SERVICES COMPANY, INC., a
Delaware corporation,

Appellant,

vs.

DONALD G. LANGE,

Appellee.

O P I N I O N

Argued and Submitted
October 19, 1989 at Portland, Oregon

Filed: OCT 24 1990

Appeal from the United States Bankruptcy Court
for the District of Oregon

Honorable C. E. Luckey, Bankruptcy Judge, Presiding

Before: JONES, MEYERS and VOLINN, Bankruptcy Judges

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1 JONES, Bankruptcy Judge.

2 The State of Oregon, Department of Veterans' Affairs
3 ("DVA") appeals a bankruptcy court order reducing its lien on
4 debtor's property to the value of the property pursuant to 11
5 U.S.C. § 506. We reverse.

6 FACTS

7 This adversary proceeding was initiated when Chapter 7
8 debtor, Donald G. Lange, filed a complaint pursuant to 11 U.S.C.
9 § 506(d) to avoid the undersecured portion of DVA's lien on his
10 property. DVA holds a \$46,000.00 consensual first mortgage
11 against Debtor's residence. At the time the complaint was filed
12 the property had a fair market value of \$42,000.00. In response
13 to Debtor's complaint, DVA filed a motion to dismiss pursuant to
14 Bankruptcy Rule 7012. DVA's motion was premised on the argument
15 that § 506 could not be used by a Chapter 7 debtor to void the
16 undersecured portion of a mortgage lien. The court denied DVA's
17 motion and declared DVA's lien void to the extent that the lien
18 exceeded the property's value. DVA timely appealed.

19 STANDARD OF REVIEW

20 The issue before us is one of statutory construction. We
21 review issues of statutory construction de novo. Trustees of
22 Amalgamated Ins. Fund v. Geltman Industries, 784 F.2d 926, 929
23 (9th Cir. 1986) (interpretation of a statute is a question of
24 law reviewed de novo).

25 DISCUSSION

26 The issue presented in this appeal is whether a Chapter 7
debtor may use 11 U.S.C. § 506 of the Bankruptcy Code to void

1 the undersecured portion of a lien on real property. The
2 language of § 506 provides a starting point for the inquiry into
3 whether a Chapter 7 debtor can utilize § 506 to "strip down"¹
4 liens on property:

5 (a) An allowed claim of a creditor secured
6 by a lien on property in which the estate has
7 an interest, or that is subject to setoff under
8 section 533 of this title, is a secured claim
9 to the extent of the value of such creditor's
10 interest in the estate's interest in such
11 property, or to the extent of the amount
12 subject to setoff, as the case may be, and is
13 an unsecured claim to the extent that the value
14 of such creditor's interest or the amount so
15 subject to setoff is less than the amount of
16 such allowed claim. Such value shall be
17 determined in light of the purpose of the
18 valuation and of the proposed disposition or
19 use of such property, and in conjunction with
20 any hearing on such disposition or use or on a
21 plan affecting such creditor's interest.

14 . . .

15 (d) To the extent that a lien secures a
16 claim against the debtor that is not an allowed
17 secured claim, such lien is void, unless-

18 (1) such claim was disallowed
19 only under section 502(b)(5) or
20 502(e) of the title; or

21 (2) such claim is not an allowed
22 secured claim due only to the
23 failure of any entity to file a
24 proof of such claim under section
25 501 of this title.

26 11 U.S.C. §§ 506(a) and (d) (1985).

Under § 506(a), an undersecured allowed claim is
bifurcated; the claim is secured to the extent of the value of

¹ The phrase "strip down" in the context of § 506(a) and (d) has gained some currency and refers to the process of reducing a secured claim to the value of the underlying collateral.

1 debtor's interest in the collateral while the remaining portion
2 of the claim is unsecured. Under § 506(d), a lien that secures
3 a claim is void, with exceptions inapplicable to this case. The
4 courts that have considered whether lien avoidance pursuant to
5 § 506(d) is available in a Chapter 7 are divided.

6 The leading cases adopting the position Debtor urges are
7 Tanner v. FinanceAmerica Consumer Discount Co. (In re Tanner),
8 14 B.R. 933 (Bankr. W.D. Pa. 1981) and Gaglia v. First Federal
9 Sav. and Loan Ass'n (In re Gaglia), 889 F.2d 1304 (3rd Cir.
10 1989). In Tanner, the court concluded that a debtor could use
11 § 506 to avoid a third mortgage lien on her home when the two
12 prior mortgages had exhausted the alleged market value of the
13 house. Relying on the explicit language of § 506 and the fresh
14 start policy underlying the bankruptcy code, the court concluded
15 that it was appropriate to permit Chapter 7 debtors to avoid
16 liens on property abandoned to or exempted by them to the extent
17 there is no supporting collateral value in the property.
18 Tanner, 14 B.R. at 935.

19 In Gaglia, the Third Circuit agreed, rejecting the
20 oversecured creditors' argument that § 506(a) does not apply
21 where a debtor has no equity in the property in question. In
22 Gaglia, the second mortgagee and its assignee argued that
23 § 506(d) does not apply where a debtor has no equity in the
24 property in question. They contended that because the debtors
25 had no equity in the property and the property would not be
26 administered, the estate likewise had no interest in the
property. However, this argument was rejected by the Third

1 Circuit which noted that such an interpretation of § 506(a)
2 would conflict with the plain meaning of § 506(d). Moreover,
3 the court pointed out that pursuant to 11 U.S.C. § 541 all of a
4 debtor's right and title to property including the legal title
5 to the property secured by a mortgage passes to the estate when
6 a Chapter 7 petition is filed. "Thus, even though the [debtors]
7 had no equity in the property, the estate had an interest in
8 it," the Third Circuit concluded. Gaglia, 889 F.2d at 1308.
9 Based on this rationale, the court permitted a Chapter 7 debtor
10 to use § 506(d) to void a lien on the unsecured portion of the
11 debt -- thereby implicitly sanctioning the avoidance of liens in
12 a Chapter 7 case even when the purpose is to reduce the secured
13 debt to the fair market value of the lien in an effort to redeem
14 or otherwise retain the property for the sole benefit of the
15 debtor.²

16 Other courts have agreed with this view, adopting the
17 premise that the plain language of § 506 contemplates its use by
18 Chapter 7 debtors. E.g., Folendore v. U.S. Small Business
19 Administration (In re Folendore), 862 F.2d 1537 (11th Cir.
20 1989). Still other courts, following the lead of In re Mahaner,
21 34 B.R. 308 (Bankr. W.D.N.Y. 1983), have denied a Chapter 7
22 debtor's use of § 506 to avoid a lien on non-estate property as
23 being contrary to the purpose of the Bankruptcy Code when all
24 Code provisions are fully considered. See Dewsnup V. Timm (In
25 re Dewsnup), 908 F.2d 588 (10th Cir. 1990); In re Mammoser, 115
26

² See footnote 3, infra.

1 B.R. 758 (Bankr. W.D.N.Y. 1990); D'Angona v. Marine Midland Bank
2 (In re D'Angona), 107 B.R. 448 (Bankr. D. Conn. 1989); Doty v.
3 Security Trust & Savings Bank (In re Doty), 104 B.R. 133 (Bankr.
4 S.D. Iowa 1989); Larson v. Alliance Bank (In re Larson), 99 B.R.
5 1 (Bankr. Alaska 1989); In re Shrum, 98 B.R. 995, (Bankr. W.D.
6 Okla. 1989); Maitland v. Central Fidelity Bank (In re
7 Maitland), 61 B.R. 130 (Bankr. E.D. Va. 1986). In Dewsnup, the
8 Tenth Circuit noted the various reasons stated by these courts
9 for denying relief under § 506. These reasons include: 1) that
10 abandoned property is not administered by the estate and
11 therefore §§ 506(a) and (d) have no application; 2) that
12 allowing this relief inequitably gives debtors more in a Chapter
13 7 liquidation than they would receive in the reorganization
14 chapters; and 3) that allowing lien avoidance pursuant to §
15 506(d) renders the redemption provision found in Code § 722
16 meaningless. Dewsnup, 908 F.2d at 589-590.

17 On balance, we find that the analysis of In re Dewsnup and
18 its progeny better reconciles the various provisions of the
19 Bankruptcy Code. In Dewsnup, the Tenth Circuit articulated two
20 reasons for rejecting the Third Circuit approach. "First," the
21 court said, "we reject the notion that section 506(d) must be
22 read in isolation." Dewsnup, 908 F.2d at 591. Rather, the
23 Tenth Circuit reasoned that courts should look to the provisions
24 of the whole law, and to its object and policy. "Second," the
25 court noted, "the Third Circuit's rationale does not adequately
26 recognize the [e]ffect of abandonment with its resulting
consequences, including reversion of the property to pre-

1 bankruptcy status." Id. The court reasoned that to permit
2 strip down after abandonment would defeat the purpose behind the
3 abandonment provision and run counter to the plain language of
4 the Code.

5 While the property in the present case has not been
6 abandoned³, we find Dewsnup's characterization of § 506 as
7 serving to implement a host of other Code provisions to be
8 controlling. To begin, we believe that § 506 was intended to
9 facilitate valuation and disposition of property in the
10 reorganization chapters of the Code. In our view, the "plain
11 meaning" of subsections (a) and (d) of § 506 is readily
12 discernible when read in the context of the Code. These
13 subsections are found in subchapter I of Chapter 5 captioned
14 "Creditors and Claims." Subchapter I is integral to the
15 distribution process and simply interacts with and implements
16 the remedial chapters of the Code. In other words, § 506(d)
17 provides the avoidance consequences of implementing a host of
18 discrete powers conferred in other parts of the Code rather than
19 acting as an avoiding power per se.

20 We believe that this statutory interpretation is bolstered
21

22 ³ It is well settled, that in bankruptcy cases, property
23 which is worthless, overburdened or, which for any other reason
24 yields no benefit to the general estate, is routinely abandoned
25 by the trustee. See 4 Collier on Bankruptcy, ¶ 554.01, at 554-
26 2 (L. P. King 15th ed. 1989) (cases cited at n. 3). In the
present case, although no formal abandonment proceeding has been
initiated, it is clear from the circumstances that the property
is not worth administering because of its inconsequential value.
Accordingly, absent a formal abandonment proceeding, the
property will be abandoned when the case is closed pursuant to
11 U.S.C. § 554(c).

1 through further review of the creditors rights provisions.
2 Specifically, the Code and the legislative history strongly
3 encourage repayment plans rather than liquidation. As the court
4 in Dewsnup noted, Congress has provided numerous incentives to
5 debtors choosing reorganization or rehabilitation under Chapters
6 11, 12 or 13 rather than liquidation under Chapter 7.
7 Consequently, it is unlikely that Congress intended § 506 to be
8 interpreted in a manner that permits a debtor to avoid
9 consensual liens on his residence in Chapter 7 that could not be
10 removed in one of the rehabilitative Chapters.

11 To illustrate, in a Chapter 11 proceeding a creditor can
12 make an election which would result in allowing its secured lien
13 to remain on the property to the full extent of the original
14 obligation. See 11 U.S.C. § 1111(b)(2) (1985); 5 Collier on
15 Bankruptcy, ¶ 1111.02 (L. P. King 15th ed. 1989) ("Section
16 1111(b) represents an attempt by Congress to create a balance
17 between the debtor's need for protection and a creditor's right
18 to receive equitable treatment....[S]ection 1111(b) protects the
19 legitimate expectation of the secured lender that the bankruptcy
20 laws will be used only as a shield to protect debtors and not as
21 a sword to enrich debtors at the expense of secured creditors.")
22 However, if an election is not made, the creditor still receives
23 payments on the allowed amount of the claim while the creditor
24 retains his or her lien on the unsecured portion of the debt.
25 11 U.S.C. § 1129 (b)(2)(A)(i) (1987). In other words, whether or
26 not an election is made, the holder's lien remains on the
unsecured portion of the debt.

1 Likewise, in a Chapter 13, § 1322(b)(2) prohibits the
2 debtor from modifying the mortgage if it is on its principal
3 residence and if the creditor holds no other security. See 11
4 U.S.C. § 1322(b)(2) (1987). While the debt may be severed into
5 secured and unsecured portions for treatment under the plan, see
6 Hougland v. Lomas & Nettleton Co. (In re Hougland), 886 F.2d
7 1182 (9th Cir. 1989), the terms of the debt including payments
8 may not be restructured. A debtor would have little motivation
9 for a Chapter 13 remedy with its strictures and trustee
10 supervision if § 506 alone could be used in a Chapter 7 to
11 effect a strip down of the lien. Accordingly, in our view,
12 § 506 is not the stand alone avoidance provision Gaglia mandates
13 that it become; rather, we believe that § 506 serves a very
14 plain and important function, namely the implementation of a
15 host of other provisions of the Code.

16 As suggested by the court in Dewsnup, a lien avoided under
17 § 506(d) should be preserved for the benefit of the estate not
18 the debtor. Hence, if the lien is not disposed of, it is to be
19 returned to the former lienholder pursuant to 11 U.S.C. § 725.
20 Contrarily, § 722 constitutes the only redemption remedy
21 Congress provided Chapter 7 debtors. See 11 U.S.C. § 722
22 (1987). Accordingly, we find it unlikely that Congress intended
23 a liquidating debtor to remove, for his or her sole benefit,
24 encumbrances in excess of the value of the real property.

25 Nevertheless, in Gaglia the court dismissed this position
26 by assuming that the use of § 506(d) for avoidance purposes
merely duplicates what would transpire in a liquidation.

1 However, this rationale assumes that a third party unrelated to
2 the transaction will purchase the property at a forced sale,
3 thus prohibiting lienholders from reaping the benefits of any
4 appreciation in land values. In reality, a senior lienholder
5 often purchases the property and sells it at a later time in
6 anticipation of a change in land values, or a junior lienholder
7 purchases the property, pays the senior lienholder and sells it
8 at a later time in hope of decreasing the amount of the loss.
9 Consequently, to allow a Chapter 7 debtor strip down relief
10 would deny creditors these options while giving debtors much
11 more than the "fresh start" to which they are entitled.

12 Clearly, it was not Congress' intent to allow debtors more in a
13 liquidation than they would receive in a reorganization.

14 As the Tenth Circuit points out in Dewsnup, Congress
15 provided Chapter 7 debtors with § 722 in order to permit them to
16 "redeem tangible personal property intended primarily for
17 personal, family, or household use." See 11 U.S.C. § 722
18 (1987). This section constitutes the only redemption provision
19 provided for Chapter 7 debtors. Notably, it only pertains to
20 personal property. In Maitland, the court correctly identified
21 the problem when it stated: "In light of the exclusion of real
22 property in § 722 and its express limitation to specific
23 tangible personal property, it is obvious that Congress did not
24 intend to permit a debtor to redeem his real property through
25 the use of § 506(d)." Maitland, 61 B.R. at 135.

26 Here, Debtor seeks to do exactly what § 722 provides,
except with respect to real property. As the court in Dewsnup

1 correctly noted, under these circumstances, § 506 would be used
2 as a redemption provision. We find this result to be both
3 inequitable and unfair as it would constitute an expansion of
4 debtor's rights far beyond what is contemplated in the Code.

5 Additionally, to allow comparable lien avoidance on real
6 property pursuant to § 506(d) would render § 722 superfluous.
7 One must presume that § 722 is not surplusage under the
8 fundamental rule of statutory construction. Both the United
9 States Supreme Court and the Ninth Circuit Court of Appeals have
10 consistently held that a statute should be interpreted so as not
11 to render one part inoperative. Mountain States Tel. & Tel. Co.
12 v. Pueblo of Santa Anna, 472 U.S. 237, 248-249, 105 S. Ct. 2587,
13 2594, 86 L. Ed. 2d 168 (1985); Cook Inlet Native Ass'n v. Bowen,
14 810 F.2d 1471, 1474 (9th Cir. 1987); In re Loretto Winery, Ltd.,
15 107 B.R. 707, 709 (9th Cir. BAP 1989) (settled principle of
16 construction that statute not be rendered inoperative or
17 superfluous, and all the words employed by Congress to be given
18 effect). Hence, where two meanings are possible, the Court
19 should chose the meaning that gives the fullest effect to all
20 provisions of the statute. To this end, our determination that
21 § 722 is the exclusive Chapter 7 redemption provision is
22 consistent with this statutory construction theme.

23 Specifically, our construction of § 722 does not render § 506
24 inoperative since § 506 has considerable meaning in Chapters 11
25 and 13 regarding the treatment of secured claims and in Chapters
26 7, 9, 11 and 13 where the property is being sold by the estate.

/ / /

CONCLUSION

Premised on an overall reading of the Bankruptcy Code and despite a superficial interpretation of § 506(d) as a separate avoiding power to benefit a Chapter 7 debtor, we find that § 506(d) is not available to Debtor to avoid the lien held by DVA. Accordingly, we REVERSE, aligning ourselves with those cases denying debtors the right to use § 506(d) as a separate avoiding power.